

VZCZCXRO6662

RR RUEHAG RUEHDBU RUEHDF RUEHIK RUEHLN RUEHLZ RUEHROV RUEHVK RUEHYG

DE RUEHAK #1283/01 1451115

ZNR UUUUU ZZH

R 251115Z MAY 07

FM AMEMBASSY ANKARA

TO RUEHC/SECSTATE WASHDC 2270

INFO RUCPDOC/USDOC WASHDC

RHEBAAA/DEPT OF ENERGY WASHINGTON DC

RUEHGB/AMEMBASSY BAGHDAD 0947

RUCNCIS/CIS COLLECTIVE

RUCNMEM/EU MEMBER STATES COLLECTIVE

RUEHIT/AMCONSUL ISTANBUL 2761

RUEHDA/AMCONSUL ADANA 1979

UNCLAS SECTION 01 OF 02 ANKARA 001283

SIPDIS

USDOE FOR CHARLES WASHINGTON

USDOC FOR 4212/ITA/MAC/CPD/CRUSNAK

SENSITIVE

SIPDIS

E.O. 12958: N/A

TAGS: [ENRG](#) [EPET](#) [BEXP](#) [EINV](#) [TU](#)

SUBJECT: TURKISH-AMERICAN PROJECT LAUNCHES GAS PRODUCTION

REF: ANKARA 187

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Sensitive But Unclassified. Please handle accordingly.

¶11. (SBU) SUMMARY. With political speeches and fireworks alarmingly close to a heroic gas plume, the U.S. oil development company Toreador feted new gas production at its Black Sea facility on May 20. Toreador has overcome significant problems in bringing its production on line and connecting it to the national grid. Even though the amount of gas is relatively modest and geared for domestic consumption, it serves a symbolic 'proof of concept' for hydrocarbon production while Turkey strives to build its place in the incipient "southern gas corridor". END SUMMARY.

Modest but Significant New Gas Production

¶12. (SBU) At the May 20 "first gas" ceremony for the Turkish-American joint production facility near the Black Sea town of Akcakoca, Energy Minister Guler and local officials feted the start of one-million cubic meters per day (cmpd) production with ignition of a plume of gas, fireworks, and political speeches, making frequent reference to Turkey's hoped for role in the "southern gas corridor". Although the modest production will reach only 2 million cubic meters per day, it is nevertheless a proof of concept that foreign investors can bring hydrocarbons into production in Turkey. With Turkey's overwhelming dependence on imported natural gas, every little bit helps.

Connecting to the Grid Ain't Easy

¶13. (SBU) Dallas-based Toreador Resources is the project operator, with partners American Stratic Energy and the Turkish State Oil Company (TPAO). The ceremony was held at the on-shore Cayagzi natural gas processing facility, which is fed by three shallow water offshore rigs, just in sight from the facility. Toreador Country Manager Roy Barker joked that his hair had turned gray in bringing the project to fruition. He and his CEO Nigel Lovett explained that achieving the connection to the Turkish natural gas grid was the most difficult hurdle, as it paved new ground for Turkey and involved the Energy Ministry, state pipeline company BOTAS, the energy regulator, and the gas purchaser AKSA. With delays in gaining approval for the connection, complicated by the political

election calendar, the opening was oft delayed, as the sponsors sought unsuccessfully to gain participation of the Prime Minister, ultimately settling for the Energy Minister.

New Hydrocarbon Law Stuck

¶4. (SBU) Barker explained that Turkey's long-awaited new hydrocarbon law would have facilitated connection and marketing to the natural gas grid. The industry-supported hydrocarbon law would provide greater incentives to investors and clarify regulations for new off-shore exploration and production (reftel). President Sezer vetoed the legislation in late April over a few sections of the law, including national rights to oil production and revenue-sharing with provinces. Although the law would have scaled back national champion TPAO's favored status, even TPAO was generally supportive of the effort to bring Turkey's hydrocarbon business environment up to international standards, recognizing that Turkey does not promise a geologic bonanza. Even though Parliament could over-turn the President's veto, industry observers told us the government decided not to press on with the law during the current pre-election environment (to avoid feeding political criticism for favoring foreigners). The law would also have helped Toreador with a long-standing lawsuit over its contractual rights to repatriate capital - with guarantees with respect to exchange losses.

Southern Gas Corridor Hoopla

¶5. (SBU) Minister Guler's and local politicians' speeches all extolled the Akcakoca project in the context of the burgeoning "southern gas corridor" and Turkish transit to Europe, referring to Baku-Tbilisi-Ceyhan oil pipeline and other gas and oil projects underway. In reality, the project is small and will most likely be

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designated for domestic consumption. Despite the apparent failure of the BP-led eastern Black Sea drilling two years ago, the government holds out great hopes for Petrobras-TPAO exploration elsewhere in the offshore Black Sea. (Recent announcements of licensing of Mediterranean exploration are really political rejoinders to the contentious licensing of Cypriot blocks.)

¶6. (SBU) COMMENT: Toreador has hyped and endured a "good news - bad news" story with its ground-breaking gas production, in the face of myriad legal and technical problems with capital repatriation, adjacent license disputes with TPAO, rig construction, national grid connection, and even accusations that the reserves are inflated. This is a modest but significant Turkish-American cooperation good news story. It contributes to gas market liberalization and it reduces Turkey's import dependency. As a proof of concept offering incremental gas molecules, it is a significant success that warrants celebration.

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